June 17, 2010

FROM: Angie Robyn
Deputy State Treasurer

RE: 2009 Annual Program Review

Section 166.450 of the Revised Statutes of Missouri (RSMo) requires an annual review of the Missouri Higher Education Savings Program (or "MOST") by the Director of Investments of Treasurer Zweifel's Office and the reporting of findings to the Board. The statute requires a review of five areas:

- Board administration
- Financial status
- Investment policy
- Participation rate
- Continued viability

Therefore, in accordance with these requirements, I am pleased to present the following findings from my review for calendar year 2009.

I. Board Administration

Upromise Investments Inc., a division of Upromise, Inc. assumed responsibility as program manager for the MOST Plan on June 3, 2006. The Board and Treasurer Zweifel's Office worked closely with Upromise and monitored their management of the program. The Board met quarterly during 2009, as required by law.

II. Financial Status

In this section of the report, we review the financial status of our major partners and summarize the investment performance of the most popular investment options within the MOST Plan.

A. Financial Status of MOST Partners

Financial markets recovered significantly in 2009. The financial performance of fee-based financial institutions is heavily influenced by assets under management and therefore, valuation of assets is a primary factor. The recovery of global financial markets in 2009 led to an earnings recovery for most financial institutions, coming off low levels experienced in 2008.

As a result of reductions to the federal government's subsidies to student lenders and dislocations in the student loan industry, Moody's downgraded SLM Corporation, the parent company of Upromise, in early 2009 from "Baa2" to "Ba1", which is below investment grade. Standard & Poor's and Fitch continue to maintain investment-grade ratings for SLM although

Fitch has SLM on negative credit watch. Since the downgrade, ratings have stabilized and come off of negative watch status which is a positive signal. SLM's credit rating is less of an issue for the MOST plan because none of the investments of the new MOST plan are secured by SLM; however, further downgrades to SLM Corporation's rating would be an indicator that there continues to be concerns regarding the company's profitability.

The two investment managers for the Direct Plan, The Vanguard Group and American Century Companies Inc., remain strong franchises. Although neither company is publicly traded and thus do not publish financial statements we can examine, our research of their funds indicates that both companies managed to avoid issues related to subprime mortgages or SIV's that other mutual fund firms had to face in 2008. Vanguard is the top U.S. mutual fund manager as measured by assets under management.

In terms of the credit risk of underlying investments in the Direct Plan, the Vanguard Interest Accumulation Fund invests in non-collateralized guaranteed investment contracts (GIC's) with insurance companies and banks but Vanguard requires a "AA" rating for such entities. The TIAA-CREF Guaranteed Option is invested in funding agreements with TIAA Life Insurance Company, which remains AAA-rated.

B. Performance of MOST Underlying Funds

Overall, 2009 can be described as a period of recovery. Absolute returns for equity indices were some of the best on record, recovering a significant amount of the losses experienced during the prior year of 2008. Similarly, while fixed-income investors were the relative winners in 2008, 2009 returns were also positive for typical multi-sector bond indices, but much more modest in comparison.

The absolute return for all investment options in MOST, both Direct and Advisor, was positive in 2009. The returns of the funds in the Direct Plan ranged from +1.80% for the most conservative option to +35.09% for the most aggressive. The average return for all options in the Advisor Plan was +43.16%, with a similar range. Generally speaking, the magnitude of the return for each individual fund was positively correlated with the amount of equity exposure in each alternative. Furthermore, among the options with equal amounts of equity exposure, the funds with the most International equity exposure generally fared better.

Treasurer Zweifel's Office is also responsible for monitoring the relative performance of each of the underlying investment alternatives versus an established benchmark. This effectively measures the contribution that the investment manager's expertise has on participants' returns. Despite strong absolute returns for the calendar year, relative performance can best be described as modestly weak for the period. To summarize, the investment managers' overall contribution to participants' returns was negative, albeit modestly. As of yearend, five funds in total were on the Watch List for negative short-term performance results and one fund was on the Watch List for negative intermediate-term performance results. All passive (index tracking) funds performed well, experiencing low tracking error of returns versus their relevant indices.

As of year-end, Missouri ranked #30 out of 52 and #9 out of 47 for 1yr and 3yr performance, respectively, according to savingforcollege.com.

III. Investment Policy

The Missouri Higher Education Savings Program adopted a formal investment policy governing its investments in mid-2007. The policy establishes objectives for the structuring the investment options in the Direct and Advisor Plan, formulates policies for selecting appropriate investment

managers and the use of specific investment vehicles, and establishes an investment performance process for underlying funds in the Plan. The plan is an important statement by the Board in terms of defining its fiduciary responsibilities and standards for Treasurer Zweifel's office staff and MOST partners. The policy was modified in 2008 to place the decision to place or release a fund to/from "WATCH" status under the Director of Investments of the State Treasurer's Office rather than at the board level.

IV. Participation Rate

In this section, we examine the participation rate of the MOST program. By examining the participation rate for the program, one can attempt to gauge the relative success the state's program has had in reaching the state's residents and encouraging them to increase college savings—the original goal of the IRS section authorizing these programs. The relative success or failure of states' various 529 programs rests on many different factors including the effectiveness of marketing efforts, demographic and economic conditions, cost structure and the abilities and resources of states' partners to attract and retain assets. However, one facet that has remained a constant is the competition for assets among states' program managers. As the field of firms in the 529 industry has shrunk, this competition for assets remains fierce as evidenced by the decline in fees among plans issuing new RFP's in recent years.

A. Growth of Plan in 2009

The MOST plan experienced growth in both assets and accounts during the year 2009. The asset growth in 2009 is predictable due to the market strength resulting in higher asset valuations, but the positive change in number of accounts can only be explained by increased awareness and popularity of the program.

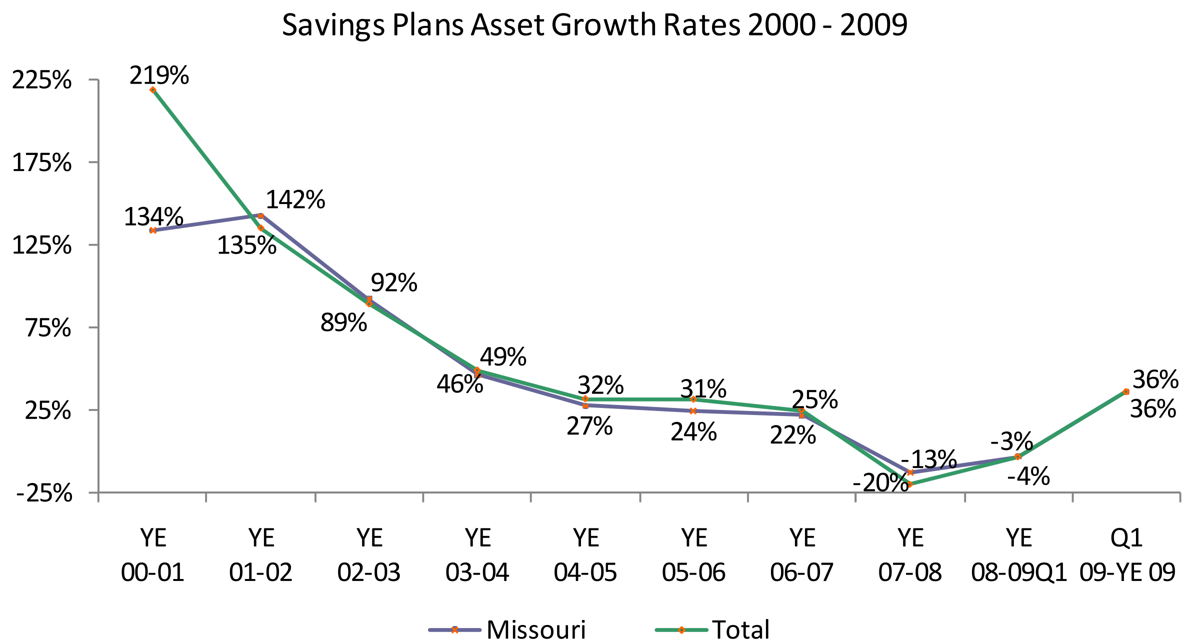
Plan assets grew by a rate of 26% ending the year at approximately $1.4 billion. Growth was experienced in both Advisor and Direct Plans. Conversely, the plan experienced a decline of -13% in plan assets during the previous year 2008. The net change over the past two years, through both the market decline and subsequent recovery, was a positive 13%.

Contributions during the period outpaced withdrawals, also contributing to the positive asset growth. Total combined contributions for both plans equaled $210 million, while withdrawals were $117 million. Contributions increased by $10 million versus $199 million in 2008. However, this is still lower than the record high contribution total in 2007 of $268 million. A reduction in contributions should largely be expected due to the economic environment, but the fact that net asset flow was positive should be viewed as a positive.

The number of accounts grew by a rate of 4% resulting in a total of 121,954 combined accounts at year end. The rate of growth was similar for both Advisor and Direct Plans. Roughly 90% of account holders are Missouri residents.

B. Comparison of MOST Participation to National Trends

Nationally, assets in 529 Plans on average have grown significantly over the past decade, but at a decreasing rate. Similar to Missouri, levels plummeted in 2008 due primarily to the financial market performance, but accounts have continued to grow signaling that popularity and awareness across the country is on the rise. Overall, the growth trends for Missouri's MOST Plan, both in respect to assets and accounts, have consistently mirrored the national rates over the past several years, evidenced by below graph.



The 529 Plan landscape is a maturing marketplace and several trends are emerging. Most noticeably is the rise in competition and its impact on program fees. As many states are having their plans re-bid for the first time, this is accelerating the fee reduction impact. As a result, some program managers are even voluntarily reducing fees in a pro-active effort to improve client retention. Innovative and cost-effective market initiatives, as well as more conservative investment options such as CDs, are also prominent trends in the 529 market. Remaining at the forefront of these market trends will be critical to the success and competitiveness of Missouri's MOST program in coming years. The re-bid of the MOST plan forthcoming in 2010 will allow us to carefully assess these trends and position MOST as a market leading 529 Plan, greatly improving college affordability for Missourians.

V. Continued Viability

The MOST program remains a viable college savings program. In Upromise's 3½ years of operation in Missouri, we have experienced strong trends in assets and accounts despite the market turmoil that plagued much of this period. We also saw an upswing in the number of new beneficiaries enrolled in the plan, which shows growth of new customers, and much better participation in the Advisor Plan among Missouri-based brokers.

The performance of the Plan throughout the economic downturn has been surprisingly resilient. The fact that participants weren't required to make non-qualified withdrawals on a large scale during this period is comforting. Furthermore, as a result, the majority of participants should have experienced almost full recovery of their college savings account balances. The economic environment remains uncertain, but the view in regards to a sustainable recovery and financial markets stability is one of optimism. With this outlook, we should expect to see growth in all aspects of the plan continue. However, the increased competition in the 529 marketplace will require even greater efforts on behalf of all parties involved to ensure these goals are met.

The following are key areas of focus for 2010 and beyond.

- Re-bid of MOST 529 contract. The Plan's contract with current provider is expiring in 2011. An RFP process will be begin in 2010. This process will allow us to carefully

reasses critical elements of the Plan and attract the program manager that can best deliver. Minimizing fees for participants and a comprehensive and simplistic investment alternative line-up are the primary objectives.

- Marketing efforts and budget were significantly increased in 2009 and results were highly successful. Generating innovative and cost-efficient methods to increasing awaremeness will remain paramount.
- Treasurer Zweifel continues to explore several new initiatives including a grant program for low- and moderate-income families.
- The development of a 529-qualified bank CD plan, which has been held up by regulatory issues, continues to be examined by the board and staff.
- Improved client service from our program manager is essential for maintaining a strong reputation for the Plan.

Missouri's MOST 529 Plan remains not only viable, but well positioned for growth. The forthcoming RFP and the current dynamic state of the market will make 2010-2011 a critical period in determining success of the Plan in the future. Treasurer Zweifel and the Board remain dedicated to establishing a best in class 529 Plan, optimizing college affordability for all participants within the State of Missouri and beyond.